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Research Update:

Gas Natural de Lima y Callao S.A. (Calidda) 'BBB-' Rating Affirmed; Outlook Remains Stable

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Overview

- During 2013, Peru-based natural gas distributor Calidda's performance was in line with our expectations as it has expanded its client base and diversified its revenue stream.
- We are affirming our 'BBB-' corporate credit rating on Calidda.
- The stable outlook reflects our expectation that the company's net debt to EBITDA will approach 3.6x in 2014 and remain at about 3.5x in the next few years. We expect Calidda's EBITDA to increase as its residential client base expands.

Rating Action

On June 16, 2014, Standard & Poor's Ratings Services affirmed its 'BBB-' rating on Gas Natural de Lima y Callao S.A. (Calidda). The outlook is stable.

Rationale

The 'BBB-' corporate credit rating on Calidda reflects its "satisfactory" business risk profile due to its stable cash flow generation stemming from a very low industry risk and its monopolistic position in the department of Lima and Callao province in Peru. The rating also considers its status as a subsidiary of Empresa de Energia de Bogota S. A. E. S. P. (EEB; BBB-/Stable/-), a Colombia-based, diversified energy holding company that owns 60% of Calidda. The rating is constrained by Calidda's "intermediate" financial risk profile and by the 'BBB-' rating on its parent.

Calidda's primary economic activity is the distribution of natural gas in the department of Lima and the Callao province through a 33-year concession with the government to build and operate the gas distribution network. The contract can be extended up to 60 years. During the concession period, the company is responsible for building, operating, and maintaining the natural gas distribution system, servicing residential, commercial, and industrial clients, electricity generators, and vehicle gas stations.

Calidda's competitive position is "satisfactory," primarily reflecting its strong to adequate regulatory advantage due to the company's monopolistic position in Lima and Callao, which generate the most GDP in Peru.

The company's growth prospects are supported by Peru's promising economic growth initiatives and favorable natural gas consumption trends. The rating on

Calidda incorporates a less diverse client base compared to other distribution companies in the region due to the higher sales share that electricity generator clients represent in Calidda's portfolio. The company distributes gas to 15 power generators in its concession area. Power generator revenue share has fallen significantly, to 27% in 2013 from 34% in 2012, and we expect it to decline to less than 20% in the next three years as Calidda limits its exposure to the generators' counterparty risk. While we believe Calidda's margins will improve as growth in its residential and commercial segments continues, the company will continue to lag behind its peers in the short to medium term. During 2013, Calidda's residential and commercial client base grew 60% while industrial clients increased 10%, and the number of natural gas vehicle stations it supplies rose 7%.

Our view of Calidda's "intermediate" financial risk profile considers the stability of its cash flows and its current and expected key financial ratios. Our base case assumes that the regulator will raise distribution rates by an average 20% during the current review cycle. This should allow Calidda to post a debt-to-EBITDA ratio of 3.6x (our debt to EBITDA ratio considers 75% of available cash and short term investments in our debt to EBITDA calculations). The rate hike will likely lead to EBITDA interest coverage to debt of 6.0x, and funds from operations (FFO) to total debt of 17% by year end 2014. In 2015, we expect the company's leverage to remain stable at about 3.5x as its EBITDA continues to increase following revenue and slight margin growth while financing additional capital expenditures (capex) with small debt issuances.

Group Influence

We consider Calidda a "strategically important" subsidiary of EEB because it is unlikely that EEB would sell Calidda in the near term, it's important for the group's long term strategy, senior group management has made a long-term commitment to Calidda, and it's successful in its business line. In our opinion, EEB will continue to support Calidda, mainly through its business expertise and its commitment to prudent financial management.

Liquidity

We assess Calidda's liquidity as "adequate." We expect sources to exceed uses by about 1.5x in 2014 and 1.2x in 2015, which provides protection against adverse events. We also expect sources to exceed uses even if EBITDA were to decline by 15%. Our assessment of the company's liquidity also incorporates its good access to credit, its flexibility in capex and future dividend payments. The company also benefits from potential support from its owners, EEB and Promigas S.A. E.S.P (not rated), if needed.

Principal Liquidity Sources

- Cash balance of about $83 million as of March 31, 2014; and
- FFO generation of approximately $51 million in 2014.

Principal Liquidity Uses
- Working capital outflows for about $2-10 million in 2014; and
- Capex for about $100 million in 2014.

Outlook

The stable outlook reflects our expectation that the company's key financial ratios will improve over the next two years following its continued network expansion. In particular, we expect the company's debt-to-EBITDA ratio will drop to about 3.5x from 2015 onwards, and its FFO to debt will reach 19%.

Downside scenario

We could lower the ratings if Calidda generates lower-than-expected cash flow that could pressure its financial metrics (FFO-to-debt ratio of less than 13%, and a debt-to-EBITDA ratio above 4.5x) due to lower-than-expected EBITDA growth or if it takes on significant debt to fund additional capex or dividend payments. A negative action on its parent company, EEB, could also lead us to lower the ratings.

Upside scenario

A positive rating action could follow a material improvement in the company's key financial ratios (total debt-to-EBITDA ratio of less than 3.0x and an FFO-to-debt ratio higher than 23%), and a significant increase in client diversity stemming from a a boost in residential customer revenues in conjunction with an upgrade of its parent company.

Ratings Score Snapshot

Corporate Credit Rating BBB-/Stable/--

Business risk: Satisfactory
- Country risk: Moderately high
- Industry risk: Very low
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

- Group credit profile: bbb-
- Entity status within group: Moderately strategic (no impact)

Related Criteria and Research

- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013

Ratings List

Ratings Affirmed

Gas Natural de Lima y Callao S.A. (Calidda)	
Corporate Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

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